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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1932

No. 215

E. G. PALMER, Petitioner,

versus

MRS. AGNES B. McGRAWL BENDER, ADMINISTRATRIX OF THE ESTATE OF JACOB O. BENDER, LATE COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF LOUISIANA,

Respondent.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

REPLY BRIEF OF PETITIONER TO OPPOSITION OF RESPONDENT.

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Montgomery-Andree Printing Co., Inc., 430-32 Chartres, N. O., La.

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May It Please the Court:

This cause is pending here on petition for a writ of certiorari to the United States Circuit Court of Appeals

for the Fifth Circuit. Respondent has filed a brief in opposition, to which we desire to make this short reply.

Respondent has discussed the applicable jurisprudence of Louisiana from the standpoint of the common law theory of lease, and its distinction between assignment and sub-lease. This is a basic error, because there is a fundamental difference between the common law and civil law theories of lease. Common law authorities are inappropriate in a discussion of Louisiana leases *(Viterbo v. Friedlander, 120 U. S. 707)*, and for that reason the cases from states other than Louisiana, cited in respondent's opposition, are wholly inappropriate.

The decisions of the United States Circuit Court of Appeals for the Fifth Circuit, in *Waller v. Commissioner, 40 F. (2) 892*, and *Herold v. Commissioner, 42 F. (2) 942*, are in direct conflict with the jurisprudence of Louisiana, reaffirmed in *Roberson v. Pioneer Gas Co., 173 La. 313, 137 So. 46*, subsequently decided. The Circuit Court of Appeals, in deciding the present case refused to follow *Roberson v. Pioneer Gas Co.*, saying the point was not at issue. Respondent so argues here.

In *Roberson v. Pioneer Gas Co., supra*, as pointed out in our original brief, it was necessary to decide whether the instrument in question was a sub-lease or assignment, in order to determine the effect of drilling under that transfer on a part of the premises covered by the original lease. The doctrine of *Roberson v. Pioneer Gas Co., supra*, is not revolutionary; it is the logical statement of Louisiana jurisprudence of sound juridical foundation, which has developed in this manner.

The Revised Civil Code provides:

"Article 2439. The contract of sale is an agreement by which one gives a thing for a price in current money, and the other gives the price in order to have the thing itself.

"Three circumstances concur to the perfection of the contract, to-wit: the thing sold, the price and the consent."

"Article 2464. The price of the sale must be certain, that is to say, fixed and determined by the parties.

"It ought to consist of a sum of money, otherwise it would be considered as an exchange."

"Article 2671, under Title IX of Lease. The price should be certain and determinate, and should consist of money. However, it may consist in a certain quantity of commodities, or even in a portion of the fruits yielded by the thing leased."

These articles have come down to us in almost identical language from the Code of 1808, through the Code of 1825. Their origin is to be found in the Civil Law of France, Spain and Rome from which the Civil Code is principally derived.

Based on these articles, the Supreme Court of Louisiana has universally held mineral contracts on a royalty basis to be leases. *Spence v. Lucas, 138 La. 763; Wilkins v. Nelson, 155 La. 807; Wilkins v. Nelson, 161 La. 437.*(1)

(1) Respondent has cited Wilkins v. Nelson, 155 La. 807, to support his contention that royalty may not be rent, but part of the purchase price. In Wilkins v. Nelson, 161 La. 437, construing the identical contract, the Supreme Court said: "At the outset it may be well to note that the mineral contract in question was declared to be a lease in Wilkins v. Nelson et al, 155 La. 810, 99 So. 607, the plaintiff in that case having attempted, unsuccessfully, to annul said contract for lesion, alleging that it evidenced a sale of the oil and gas beneath the surface of the land."

Following these cases, and based squarely on the Codal articles, the Supreme Court of Louisiana held that the lessor was entitled to a lessor's lien and privilege for unpaid royalty, because royalty was rent. *Logan v. State Gravel Co., 158 La. 105.*

Next the Supreme Court of Louisiana held that oil royalty under an oil and gas lease was rent and subject to the prescription of three years under Revised Civil Code, Article 2538, relating to arrearages for rent. *Board of Commissioners v. Pure Oil Co., 167 La. 801.*

In *Smith v. Sun Oil Co., 165 La. 907*, it was necessary to decide whether an instrument transferring part of a lease was a sub-lease or assignment, in order to determine the effect of drilling on the part of the lease affected by that instrument. The decision in that case contains a precis of the French authorities on the question, all of whom agree that an assignment is a sale and that a sub-lease is a lease.

In that case, the Supreme Court of Louisiana used the term "reversion" in referring to a right which would have existed, without having been expressly stipulated, under the articles of the Civil Code relating to the resolutory condition in all contracts, and to leases in particular. (See *Arts. 2046, 2711, 2712 and 2729, Rev. Civ. Code*).

Of course the Court did not mean to use the term "reversion" in the technical sense with which that word is used in common law to distinguish sub-leases from assignments. The Board of Tax Appeals in the *Waller* case *(16 B. T. A. 574)* and the Circuit Court of Appeals in both

the *Waller* and *Herold* cases *(Waller v. Commissioner, 40 Fed. (2) 892; Herold v. Commissioner, 42 Fed. (2) 942)* seized upon this term, and construing it in the light of the common law, rushed to the incorrect conclusion that Louisiana civil law and the common law were the same with respect to this distinction.

Roberson v. Pioneer Gas Co., supra, wherein the Supreme Court of Louisiana found it necessary to distinguish between sub-lease and assignment, in order to determine the effect of the transfer of part of an oil and gas lease, very properly explained that its use of the term "reversion" in *Smith v. Sun Oil Co., supra,* was not meant to connote the technical common law meaning of that term.

The same Circuit Court of Appeals held *Roberson v. Pioneer Gas Co., supra,* to establish a rule of property in Louisiana *(Harrell v. United Carbon Co., 52 F. (2) 790),* which it was bound to follow under *Griffey v. Smith, 237 U. S. 101.*

The Circuit Court of Appeals has followed the conclusion of *Roberson v. Pioneer Gas Co., supra,* in that case, and here has declined to follow the premise which that same Court established in order to reach that conclusion. Its decision in the case now before the Court is therefore necessarily in conflict with the entire jurisprudence of Louisiana on the subject, and we respectfully urge that the error should be corrected here.

The other cases cited in respondent's brief in opposition are not even remotely in point, and we shall not discuss them here. The entire jurisprudence of Louisiana

on the question involved in this suit, has been cited in our original brief. That jurisprudence is logical and consistent and sustains the contention of petitioner.

As we have done before (but without response), so do we now challenge respondent to cite one Louisiana case or one Codal provision in conflict or inconsistent with petitioner's position in this case; or to cite one Louisiana case or one Codal provision which even remotely upholds the decision of the Circuit Court of Appeals or respondent's position in this case.

The principle of bonus depletion was recognized by the Circuit Court of Appeals for the Ninth Circuit in *Murphy Oil Co. v. Burnet, 55 Fed. (2) 17* (Certiorari granted May 31, 1932, No. 955 of the Docket of this Honorable Court). In this case the Circuit Court of Appeals came to a contrary conclusion. The facts were essentially the same, except that the "basic date" for revaluation in the *Murphy* case was March 1, 1913, the lease having been previously acquired, and here the "basic date" is March 30, 1921, the date of discovery of oil.

The provisions of the Revenue law and regulations under which petitioner seeks refund do not in any manner apply to the Ohio Oil Company, and Gulf Refining Co., sub-lessees, for their depletion is based on cost, their rights having been acquired after March 1, 1913, and after discovery.

We have fully covered the question of the validity of the appropriate Revenue laws and regulations upon which petitioner relies, in our original brief.

The Government, in respondent's opposition in this Court, has denied for the first time in this protracted litigation that the Revenue laws and regulations involved apply to sub-lessors.

In the *Waller* case, in the Board of Tax Appeals *(Waller v. Commissioner, 16 B. T. A. 574)* the Government conceded that if the transfer involved was a sub-lease, petitioner would be entitled to depletion under T. D. 3938 (C. B. V.-2, p. 117).

In its brief in the Circuit Court of Appeals in this case, respondent said that "under the applicable statutes and Treasury Department (pp. 16 and 18, *supra*) a lessor, including a sub-lessor, of mining property is entitled to a deduction from income on account of depletion."

That is clearly correct, because, under Louisiana law, a sub-lease is a new lease, superimposed on the primitive lease, and one in which the original lessee becomes the lessor. *(Smith v. Sun Oil Co., supra).*

The petitioner had a 7/8ths interest in the property at the time of the discovery of the well. By the terms of the instrument in question he subleased to the Ohio Oil Company, retaining a valuable property right and interest in the form of a 1/8th overriding royalty. At all times the petitioner had a valuable interest in the property. This Court in *Lynch v. Alworth-Stephens Company, 267 U. S. 364,* dealing with the rights of sublessors held that an allowance for exhaustion of ore deposits "is to be made to everyone whose property right and interest therein have been depleted" * * *

The trial judge would have decided in favor of petitioner on all questions at issue, but that he felt constrained to follow *Waller v. Commissioner, 40 Fed. (2) 892*, and *Herold v. Commissioner, 42 Fed. (2) 942.* (R. p. 98).

The Circuit Court of Appeals has decided a question of local Louisiana law contrary to the established jurisprudence of Louisiana. It has in effect denied the validity of article 215 (a) of the Regulations of the Department as amended by Treasury Decision 3938. Its decision is in conflict with the decision of the Circuit Court of Appeals of the Ninth Circuit in *Murphy Oil Co. v. Commissioner (55 Fed. (2) 17).*

We respectfully submit that this petition should be granted in order that this Honorable Court may review the questions presented and in due course reverse the decision of the Circuit Court of Appeals.

All of which is respectfully submitted.

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